State of Louisiana

M.J. "MIKE" FOSTER, JR.
GOVERNOR

JACK C. CALDWELL
SECRETARY

DEPARTMENT OF NATURAL RESOURCES

MINERALS MANAGEMENT SERVICE ROYALTY MANAGEMENT PROGRAM DOCUMENT CONTROL STAFF
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March 18, 1996

Mr. David Guzy
MMS Rules and Procedures
Post Office Box 25165
Mail Stop 3101
Denver, Colorado 80225

VIA FEDERAL EXPRESS

Re: Comments concerning use of posted prices for valuation of oil

Dear Mr. Guzy:

MMS has asked that interested parties provide comments concerning the suitability of oil posted prices as a valuation tool, and to offer alternative methods for valuing oil in situations where the oil is sold non-arm's length to an affiliate or subsidiary. Louisiana receives significant amounts of royalties from Federal lands that lie within the State and lands lying in the "8G" zone. Therefore, federal regulations relating to the valuation of oil produced from those lands have a fiscal impact on the State. The Louisiana Department of Natural Resources (DNR) supports the Minerals Management Services' (MMS) efforts to come up with revised valuation criteria to use in crude oil valuation.

The staff of DNR, among its many duties, regularly audits the records of oil and gas royalty payments paid to the State of Louisiana by its lessees of State lands. Based upon audit experience, we have noticed that since the late 1980's posted price in most cases involving third party transactions served as only a part of the total price component. In the majority of sales to third parties, bonuses on top of postings were paid to the producer.

In the past, MMS allowed posting to be used as a benchmark in non arms's length transactions. In effect, MMS has allowed large integrated oil companies to sell oil to themselves and value that transaction at posting, regardless of what the true market value for that oil is.

In situations where producers sell to their affiliates/subsidiaries, we feel that the most appropriate valuation method would be to use the resale price that the affiliate receives when the oil is sold to true third parties. If the oil is commingled with other production, the sales price of the commingled production would be used, with due consideration being given to quality/location/gravity differentials ("costs") that may exist. If the oil is sold to several different purchases, the weighted average sales price would then be the determinant of value.

In situations where oil is not sold to third parties either by the lessee or its affiliate, we suggest that average prices published for market trading centers (Cushing, St. James, Empire, etc.) nearest the production area be used. Again, consideration should be given to the "costs" that may exist.

If the lessee maintains complete control over its oil all the way to its refinery, average monthly spot prices at the nearest trading centers less allowable "costs" would be the preferred method of oil valuation.

In situations where the lessee (or its affiliate/subsidiary) sells a volume of oil to a third party under terms of an exchange agreement or a buy-sell agreement where the buying party sells the lessee an equivalent volume back at a similar price but at a different location (sometimes with a location differential built in), the options set forth above would apply, depending on how the lessee disposes of the bought back oil.

To sum up, DNR knows that in most instances, third party sales of oil in the late 1980's and continuing into the 1990's have brought prices to the lessee/producer in excess of posted prices. Also, in most cases, integrated companies have paid themselves only their posted prices when buying oil from them selves. Therefore, efforts by the MMS to revise oil valuation regulations to place a more accurate value on oil produced from Federal lands are necessary.

Sincerely,

Jack C. Caldwell / by CB

Jack C. Caldwell
Secretary

JCC:sm